May 5, 1995

SDR-922-95-04
MTBIL-020608B
3165.3 (922.JA)

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

DECISION

Shell Western E & P, Inc.
P.O. Box 576
Houston, Texas 77001

SDR No. 922-95-04

Affirmed

Shell Western E & P, Inc., (SWEPI) requested a State Director Review (SDR), of a Notice of Incident of Noncompliance (INC) (Enclosure 1), issued by the Miles City District Office (MCDO) on March 24, 1995, for drilling the 31-29H well in federal lease MTBIL-020608B without approval. The SDR request was considered timely filed on April 24, 1995, in accordance with 43 CFR 3165.3(b) and assigned number SDR-922-95-04.

Specifically, SWEPI requests review of the finding in the INC that the 31-29H well must be classified as a federal well and will be subject to federal regulation since the wellbore penetrates the federal lease.

On May 17, 1994, SWEPI obtained approval from the State of Montana Board of Oil and Gas Conservation (Board) to re-enter the Cedar Creek Anticline Unit 8A (Unit) well No. 31-29H, located in the NWNE sec. 29, T. 5 N., R. 61 E., Fallon County, Montana. The well to be re-entered was a private well located in a non-participating area of the Unit. The plan approved by the Board indicated that the well would be re-entered and a horizontal leg would be drilled in a southeasterly direction. This horizontal leg was projected to terminate 200 feet from the section line which is also the boundary of the federal lease. The BLM was provided with a copy of the permit approved by the Board on May 23, 1994 (Enclosure 2).

On August 30, 1994, SWEPI commenced drilling operations on the well. A fault was encountered prior to reaching the bottomhole location while drilling the horizontal leg. This resulted in loss of the target reservoir. The original horizontal wellbore was subsequently sidetracked by SWEPI in an attempt to relocate the target reservoir. The second horizontal leg penetrated federal lease MTBIL-020608B in sec. 28 on September 13, 1994, and total depth was reached later the same day. At total depth, the second horizontal leg penetrated 92 feet (123 feet measured depth) into the federal lease. Both sec. 29, which contains privately owned surface and minerals, and sec. 28, which contains federal surface and minerals, are within the non-participating area of the federally approved and supervised Unit.

The MCDO received courtesy copies of the Board Completion Report and a sub-surface directional survey report from SWEPI on March 13, 1995. During the review of these reports, the MCDO discovered that the federal lease had been penetrated without prior approval. The MCDO determined that an INC was appropriate for a violation of the regulations at 43 CFR 3162.3-1(c), which requires submission of an Application for Permit to Drill (APD) for each well and prohibits drilling and surface disturbance preliminary thereto, prior to

the authorized officer's approval of the permit. However, the MCDO determined that the immediate assessment for drilling without approval (43 CFR 3163.1(b)(2) should not be imposed because of the circumstances surrounding the case (Enclosure 3). The MCDO recommended that the State Director (SD) waive the mandatory assessment under the authority provided at 43 CFR 3163.1(e) on March 17, 1995. The assessment was waived by the Deputy State Director (DSD), Division of Mineral Resources on March 24, 1995 (Enclosure 4). The DSD concluded that the waiver of the assessment was appropriate because SWEPI's failure to obtain approval was inadvertent (Enclosure 5).

The argument presented by SWEPI included the following statements and conclusions:

> In a lease situation where all interests are pooled through the existence of a federally approved and supervised unit, the classification of wells as federal or non-federal should be based solely on the lease ownership directly underlying the surface location of the well.
>
> The royalty paid to the United States (US) from the production of the 31-29H well would remain the same regardless of the location and classification of the well because of the terms of the Unit agreement. The federal regulations fail to directly address wells that are drilled on lands outside of a federal lease boundary which enter federal minerals and ultimately include at least some production from such minerals.
>
> The instant case is similar to M.J. Harvey, Jr. (Harvey), 109 IBLA 31 (1989), because federal resources are not impacted by either case. In Harvey, no drainage would occur and in the instant case the federal lease is already included in a federally approved and supervised unit, therefore no overall impact to federal resources and no need to classify the 31-29H well as a federal well.

We agree that the royalty paid to the US is not dependent on the classification of the well in this case. We also agree that the case is not specifically covered by the regulations. However, both the Board permit and BLM APD forms include the location of wells at the surface and at the proposed production zone or bottomhole location. These forms clearly account for directionally drilled wells or horizontal wells that could have surface locations off-lease, as in the instant case. The production zone or bottomhole location determines agency jurisdiction.

In Harvey, the BLM did not require an APD. The federal minerals were passed through in search of a target reservoir by a party who was not authorized to develop the federal minerals; therefore, the BLM's review was limited to making a determination of whether the lessors exclusive right to explore and produce the federal minerals was in jeopardy. The purpose of Subpart 3160 - Onshore Oil and Gas Operations: General found at 43 CFR 3160.0-1 states: "The regulations in this part govern operations associated with the exploration, development and production of oil and gas deposits from leases issued or approved by the US,...." The BLM determined that the provisions of 43 CFR 3162.3-1(c) did not apply because the proposal was solely for the development of fee minerals. The BLM reviewed SWEPI's drilling plan and determined that the federally leased horizons intersected by the proposed well and the lessees rights would be protected, if SWEPI properly circulated cement about the casing. Therefore, the BLM determined that the operations in Harvey did not involve any exploration, development, or production of oil and gas deposits from federal leases and concluded that an APD was not necessary or appropriate.

In this particular case, the intersection of federal minerals was clearly intended to develop and produce such minerals; therefore, the regulations in Subpart 3160 do apply. We affirm the MCDO determination that the 31-29H well was a federal well and their subsequent issuance of the INC for drilling without approval.

This Decision may be appealed to the Board of Land Appeals, Office of the Secretary, in accordance with the regulations contained in 43 CFR 4.400 and Form 1842-1 (Enclosure 6). If an appeal is taken, a Notice of Appeal must be filed in this office at the aforementioned address within 30 days from receipt of this Decision. A copy of the Notice of Appeal and of any statement of reasons, written arguments, or briefs must also be served on the Office of the Solicitor at the address shown on Form 1842-1. It is also requested that a copy of any statement of reasons, written arguments, or briefs be sent to this office. The appellant has the burden of showing that the Decision appealed from is in error.

If you wish to file a Petition for a Stay of this Decision, pursuant to 43 CFR 3165.4(c), the Petition must accompany your Notice of Appeal. A Petition for a Stay is required to show sufficient justification based on the standards listed below. Copies of the Notice of Appeal and Petition for a Stay must also be submitted to each party named in this Decision and to the Interior Board of Land Appeals and to the appropriate Office of the Solicitor (see 43 CFR 4.413) at the same time the original documents are filed with this office. If you request a stay, you have the burden of proof to demonstrate that a stay should be granted.

Standards for Obtaining a Stay

Except as otherwise provided by law or other pertinent regulation, a petition for a stay of a Decision pending appeal shall show sufficient justification based on the following standards:

(1) The relative harm to the parties if the stay is granted or denied,

(2) The likelihood of the appellant's success on the merits

(3) The likelihood of immediate and irreparable harm if the stay is not granted, and

(4) Whether the public interest favors granting the stay

/s/ Thomas P Lonnie

Thomas P. Lonnie
Deputy State Director
Division of Mineral Resources

6 Enclosures
1-MCDO INC Dated March 24, 1995 (3 p)
2-Board, May 17,1994 Approved Drilling Permit (14 p)
3-MCDO Letter to the SD Dated March 17, 1995 (2 p)
4-DSD Letter to the MCDO Dated March 24, 1995 (1 p)
5-Memo on Rationale for Waiving Assessment (1 p)
6-Form 1842-1 (1 p)

cc: (w/encls.)
MCDO